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Social Security, Inter-Generational Fairness and Equity indicators

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SOCIAL SECURITY, INTER-GENERATIONAL FAIRNESS AND EQUITY INDICATORS

Policy brief

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The welfare of the elderly needs to be a priority for policy makers.

Since the elderly represent one of the most fragile fractions of the population, the way society treats them is indicative of its level of progress and civilization. Helping the elderly does not (at least in the short term) carry the traditional disincentive effects (i.e., moral hazard) that assisting other age groups may have. This could explain why even societies that are not noted for their generosity towards their weak members do make an exception for the elderly. Witness the various US assistance programs aimed at the elderly: Social Security, Medicare, Supplemental Security Income benefits

Why do we need comparable indicators?

First, we need to measure as accurately as possible the average level of welfare assistance for the elderly and its distribution, with particular emphasis on the poor. This is the only way one can assess the performance of various social protection programs aimed at the elderly.

Second, by publicizing a set of non-controversial welfare measures, we hope to put pressure on countries that are doing badly to improve upon and to induce the countries performing well to keep going. This is the spirit of the European method of open coordination, or what is more generally known in economics as *yardstick competition*.

What should a measure of welfare for the elderly include?

We would like to use indicators that are widely accepted and not subject to manipulation. In that respect the demographic indicators are known to be

quite robust, while the measures based on lifestyle experiences, or on subjective approaches, are controversial. The specific features to be considered when dealing with old age pertain to health, longevity, family composition, intergenerational transfers, and level of activity.

Health

It is clear that the welfare of elderly people depends on their degree of health. In fact, most of the studies on happiness show that, particularly in old age, happiness depends more on being healthy and surrounded by friends and relatives than on having a high income. It is thus interesting to weigh the level of income or consumption of elderly individuals by means of an index of health, or what is sometimes called *qualis*.

Longevity

Differences in longevity may bias international comparisons of welfare. We assume that longevity is positively related to the income and the wealth of elderly, and that this relation is particularly marked in less advanced countries. This being the case, one expects the relative welfare of the elderly to be higher in countries with relatively low longevity.

Intergenerational links

One cannot approach the welfare of elderly by disregarding the intergenerational dimension. As mentioned above, it is extremely important to be surrounded by one's children, not only for the services they provide (this being particularly true for dependent people in need of long term care), but especially for their love.

In most countries the welfare of the elderly depends on intergenerational transfers forced upon future generations by the State. This is the case of PAYG pensions, whereby old age benefits are paid by a fraction of the wages earned by workers who belong to the next generation. Given that the rate of return on the financial market is higher than the rate of return of the PAYG system, there is some redistribution from the young to the old.

Additionally, in terms of social justice what really matters should not be the well being of the elderly, e.g., as compared to that of a younger cohort, but

the welfare of the elderly over their life cycle relative to that of a younger cohort, also viewed over its whole life cycle.

Activity

The welfare of an elderly person is likely to be related to his/her level of health and longevity. What about his/her level of activity? All things being equal (income, longevity, health), is it preferable for someone aged 60 to work for 5 more years, or to retire at once? Economists tend to think that the latter alternative is superior because of the disutility of labor. But this opinion could change if, instead of formal work, one were to talk of voluntary activity, or even of part-time voluntarily chosen work.

Forthcoming data base.

For answers to the many questions pertaining to the material well-being of the elderly, their health and family links, one would do better to rely on a comparable database for a dozen countries. In line with the American HRS (Health Retirement Survey) and the English ELSA (English Longitudinal Survey on Ageing), SHARE (Survey on Health, Aging, and Retirement in Europe) is now starting a research project with the participation of 15 European countries. The multi-disciplinary nature of the data will provide new insights to the complex interaction among the economic, health, psychological and social factors that determine the quality of life of the elderly.

Indicators of intergenerational links. Fairness and sustainability.

It would be helpful to have significant (comparable and robust) indicators of intergenerational equity and sustainability. For example, following the generational accounting tradition (Kotlikoff et al. (1999)), one would like to know the nature of the liability of each individual with respect to the future. The problem is that comparisons of generational accounts, even at the most aggregate levels, are either not reliable, or rather extremely sensitive to a number of key parameters.

A slightly less controversial measure of intergenerational redistribution is the level of pension rights that can be added to the public debt in order to assess a country's actual level of indebtedness. These could be used, but

with some caution and using the same methodology. The OECD has conducted a few studies in that direction with mixed success.

These two instruments — generational accounts and social security wealth—measure not just the extent of intergenerational redistribution, but also the sustainability of the pension system. Another measure of social security sustainability is the contribution rate needed in the future decades if one keeps the rest of the system unchanged. These measures have to be used with caution and only for qualitative assessment.

An interesting and quite robust measure is the rate of effective dependency. For example, instead of looking at the ratio of people above 65 to those between 20 and 65, one could take into account the effective age of retirement and the age at which activity starts, or one could even use the rate of employment. These measures are quite comparable, as well as informative of the sustainability of the social security system.

Intra-family solidarity and adjustment for economies of scale.

In a number of countries, particularly in the developing world, the aged do not necessarily live separately from their children. Thus, the households they live in often include both elderly and younger family members. Using this kind of data, we see household per capita income or expenditure as our basic welfare indicator. In other words, the aged may often be living in households that are not really poor, even though they themselves are not receiving any pension payments. However, if there is no equal sharing, or sharing according to need, there may be a problem.

Any analysis of poverty among the aged should be sensitive to the potential impact of economies of scale in household consumption on the perceived poverty of the aged. For without adjusting sufficiently for economies of scale, pensioner households or households headed by widows, etc., will not be not highly represented among the poor. Typically, large households with many children are the ones that appear to be particularly poor.

Adjusting for economies of scale makes the profile of poverty change dramatically, as pensioner households now appear to be at risk. The point here is that, as one thinks of ways to simulate the poverty impact of pension schemes, one also has to confront the question of what adjustments need to

be made for economies of scale. Unfortunately, we are not in a position to say categorically what the "right" adjustment should be.

Distinction among four types of generosity of the welfare state:

Following Pestieau (2003), it would be useful to distinguish among four types of incidence of social security that receive the ambiguous label of "generosity." There is:

- Average generosity, measured by the average replacement ratio to be weighted by an index of coverage
- Generosity towards early retirement, also measured by the replacement ratio for early retirees weighted, as well by an index of coverage
- Generosity towards the poor, given by the replacement ratio of the poor (bottom quintile) over the replacement ratio of the top quintile.
- Intergenerational generosity, that could be measured by the overall public debt, including social security liabilities.

Summary.

To sum up, at this point in time with the SHARE data not yet available, what indicators should we use?

I would distinguish those indicators that describe the well-being of the elderly from those indicating the sources of the well-being. In particular, this includes the incidence of social protection on these descriptive indicators.

Descriptive indicators (comparing old age with other age categories and distinguishing the very old from the not so old; giving particular attention to the equivalence scale) :

- Average income
- Poverty rates
- Health indicator
- Longevity
- Inequality indicators
- Activity rate

Incidence of social protection

Decomposition of income per sources
Income levels and poverty rates with and without social protection

Distinction among four types of generosity of the welfare state would include:

- Overall replacement ratio
- Replacement ratio of early retirees
- Replacement ratio of the bottom quintile divided by the replacement ratio of the top quintile
- Overall liability of the State with respect to future generations

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